

Legal Structures for Business Organizations

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Learning Objectives

- List the legal structures for business organizations recognized by law
- Define each legal structure for business organizations
- List advantages and disadvantages for each legal structure
- Describe the steps necessary to establish each legal structure

Legal Structures for Business Organizations

1. Sole Proprietorship
2. Partnership
3. Corporation
4. Limited Liability Company

Legal Structures for Business Organizations

Part 1 – Sole Proprietorship

Sole Proprietorship Defined

An unincorporated business that is owned by one “individual”

Sole Proprietorship Characteristics

- Compared to other structures it is the simplest to use
- Does not require government approval
- The business has no existence apart from the owner
- The owner is his or her own boss

Sole Proprietorship Characteristics

- The owner owns the business assets
- The owner is personally responsible for all debts of the business
- All liabilities of the business are the owner's personal liability

Sole Proprietorship Characteristics

- The owner has personal liability for all actions undertaken in the name of the business
- Sole proprietorship does not pay corporate income tax - income and expense are reported on the owner's personal tax return
- The owner reaps the benefits of his/her success

Sole Proprietorship Characteristics

- The business ceases upon the death of the owner
- Since the finances of the business and owner are one in the same, significant attention must be devoted to financial planning

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Part 2 – Partnership

Partnership Defined

An association of two or more persons to carry on as co-owners a business or other undertaking for profit

Partnership Characteristics

- A partnership is an entity distinct from its partners
- More legal formality than with a sole proprietorship but less than with a corporation or limited liability company
- Property acquired by a partnership is property of the partnership and not the partners individually

Partnership Formation

- In some states a partnership is “automatically formed anytime two or more persons carry on as co-owners a business for profit
- Adoption of “articles of partnership” and, in some states, filing articles with state/local government

Articles of Partnership

- Names and addresses of partners
- Purpose of the partnership
- Location of the partnership
- Amount of money, property or services each partner will contribute

Articles of Partnership

- Compensation to be paid to partners
- The procedure for dissolution of partnership
- Plan for distribution of profits and losses
- Voting rights of the partners

Relationship of Partners

- Each partner is an agent of the partnership for the purpose of its business
- Acts of an individual partner in carrying on partnership business bind the partnership, unless the partner did not have authority to act for the partnership

Relationship of Partners

- Partners are jointly liable for debts of the partnership
- Partners are jointly liable for civil liability judgments against the partnership
- Generally criminal liability of one partner will not be imputed to other partner(s)

Partnership Types

- General partnership
- Limited partnership
 - Principal distinction between a general and limited partnership is the extent of liability of a general partner versus a limited partner

General Partnership

- All partners share in the duties, profits and liabilities
- Income of partnership is income of the individual partners, but partnership must file Form 1065 with IRS

Limited Partnership

- The liability of a limited partner is limited to the amount of capital contribution to the partnership
- Generally, a limited partner may not contribute services nor perform any management or control over operation of the partnership

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Part 3 – Corporation

Corporation Defined

An association of individuals, known as stockholders, created as a business entity by an act of state government

Corporation Types

- General
 - Anyone can be a stockholder
- Professional
 - Only individuals licensed to provide the service for which the corporation was organized may be stockholders

Corporation Characteristics

- Significant legal formality compared to sole proprietorship and partnership
- Ownership is signified by shares of stock
- Does not dissolve upon death of one or more owners

Corporation Characteristics

- Limited personal liability of owner(s)
- Income/profit of corporation is taxed twice since both the corporation and the owners pay taxes

Subchapter “S” Corporation

- Special taxation status that allows avoidance of double taxation
- Corporate profit is not taxed but rather is credited directly to individual stockholders in proportion to their respective stock holdings

Subchapter “S” Corporation

- Must be a domestic corporation
- Can have only one class of stock
- Must not have more than 35 stockholders
- May not have a non-resident alien as a stockholder
- Must file IRS Form 2553

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Part IV – Limited Liability Company

Limited Liability Company Defined

An association of individuals, known as members, that share characteristics of both the individual and corporate identities

Limited Liability Company Characteristics

- May be a sole proprietorship, a partnership or a corporation
- Legal formality similar to that of corporation
- Must consist of one member and is most useful to professionals and partnerships

Limited Liability Company Characteristics

- Ownership is invested in memberships rather than shares of stock
- Offers protection from liability for actions of the business or other members of business
- Does not protect from liability for personal actions

Limited Liability Company Characteristics

- Like an “S” corporation, federal income taxes are paid only on income distributed to members

Limited Liability Company Types

- LLC – Limited liability company
- LLP – Limited liability partnership
- With both, an “entity classification election” must be made by filing Form 8832 with the IRS

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Conclusion